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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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JUN 12 1996
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services	)))	CC Docket No. 96-112

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REPLY COMMENTS OF
CONSUMER FEDERATION OF AMERICA AND
INTERNATIONAL COMMUNICATIONS ASSOCIATION

Bradley Stillman, Esq.
Telecommunications Policy Director

Dr. Mark N. Cooper
Research Director

Counsel for
Consumer Federation of America

1424 16th Street, N.W., Suite 604
Washington, DC 20036

Of Counsel:

Brian Moir
Moir and Hardman
2000 L Street, N.W., Suite 512
Washington, DC 20036

Counsel for International
Communications Association

June 12, 1996

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The Consumer Federation of America (CFA) and International Communications Association (ICA) offer these reply comments in the video cost allocation docket.[1] We believe this is a docket that is long overdue.

I. THE COST ALLOCATION PROCEEDING IS LONG OVERDUE

A. AS A MATTER OF PUBLIC POLICY, THIS RULEMAKING IS LONG OVERDUE

Over three years ago, CFA petitioned the Commission to undertake a rulemaking to deal with the critical and growing problem of cost allocation for integrated, multi-product telecommunications firms (see Attachment 1).[2] We are pleased that the fundamental problems of massive amounts of common costs being misallocated to telephone ratepayers are being formally recognized by the Commission in this proceeding.

Claims by local exchange companies that this proceeding is sudden or hurried are totally baseless.[3] Video applications from the LECs have advanced from the theory, to analysis, to large scale demonstration all without cost allocation rules in place. A cost allocation proceeding must be completed before the companies move any further down the road toward providing video services.

B. AS A MATTER OF ECONOMICS, STRONG COST ALLOCATION RULES MUST BE IN PLACE

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[1]Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, Notice of Proposed Rulemaking, CC Docket No. 96-112, FCC 96-214 (rel. May 10, 1996) ("Notice").

[2]Joint Petition of the Consumer Federation of America and the National Cable Television Association for Rulemaking and Request for Establishment of a Joint Board, F.C.C.R. 2919 (1993).

[3]Southwestern Bell Telephone Company, pp. 2-3; Ameritech, note 2. Throughout these reply comments, we refer only to the name of earlier commentors. All such references are to comments filed in the proceeding identified in note 1. above.

With this Rulemaking, the Commission recognizes a fundamental principle of economic analysis. The shared use of facilities not only requires that all services which use those facilities pay a part of the costs, it also requires careful cost causative analysis to ascertain whether one particular set of services is causing the costs. It is a simple fact of engineering analysis that the most demanding application drives the engineering and design characteristics of physical facilities.

The fact that video bits moving over a shared facility cause costs and incur cost responsibility should be followed to its logical conclusion. It is precisely the same type of analysis that has led us to insist that all telephone services using shared facilities cause costs and incur cost responsibility.[4] When long distance bits move over common facilities (i.e. the loop), they have cost causative impacts and incur cost responsibilities.

Attachment 2 to these comments presents a chapter from a report published by the Public Policy Institute of the American Association of Retired Persons.[5] It recounts the repeated instances in which technological changes have been incorporated into the telecommunications network and the cost causation and cost responsibility that flow from those changes. It begins with the history of the process through which local and long distance services were integrated into one network and the cost causative principles that should be applied to this integration. Just

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[4]"Comments of the American Association of Retired Persons, the Consumer Federation of America and consumers Union," <u>In the Matter of Federal-State Joint board on Universal Service, Notice of Proposed Rulemaking and Order Establishing Joint Board</u>, Federal Communications Commission, CC Docket No. 96-45.

[5]Richard Gable, <u>The Impact of Premium Telephone Services on the Design, Operation and Cost of Local Exchange Plant</u> (American Association of Retired Persons, Washington, D.C., 1992).

as video and telephony are provided over separate networks, but merging into one network, so too long distance and local were provided over separate networks that were merged into one as a matter of corporate investment strategy.

The report proceeds to analyze similar processes for the introduction of direct dialing and digitization of the network. The ongoing modernization of the network for the provision of enhanced and video services is only the latest in a long history of network changes that demand cost causative analysis.

C. AS A MATTER OF LAW, THIS PROCEEDING IS ABSOLUTELY NECESSARY

In our comments in the universal service and local competition proceeding,[6] we have stressed the critical importance that the allocation of joint and common costs plays under the Telecommunications act of 1996.[7] The language of §254(k) could not be more precise -- basic service can bear, at most, a reasonable share of joint and common costs. Congress went well beyond a formal definition of cross-subsidy, however, to state a clear public policy preference for cost allocators when it required "cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."[8] The Conference Report makes a point of stating that in adopting §254(k) the House is receding

[6]"Comments of the Consumer Federation of America and Consumers Union," In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996. CC Docket No. 96-98, May 16. 1996 (hereafter CFA, Competition Comments).

[7]Telecommunications Act of 1996, Pub. L. No. 104-104, 101 Stat. 56(1996), hereafter the 1996 Act.

[8]At para. 23, The Notice cites only the first sentence of section 254(k), which deals with cross-subsidy. It fails to quote the second sentence which clearly goes beyond the issue of cross subsidy to the general matter of the allocation of common costs.

to the Senate.[9] The Senate report made it clear that a reasonable share of joint and common costs was the maximum that should be included in the rates for universal service, but that less could be allocated to these services.

> The Commission and the states are required to establish any necessary cost allocation rules, accounting safeguards, and other guidelines to ensure that universal service bears no more than a reasonable share (and may bear less than a reasonable share) of the joint and common costs of facilities used to provide both competitive and noncompetitive services.[10]

As the Commission recognizes, massive joint and common costs are being incurred for the provision of basic, non-basic, and competitive telecommunications services, as well as video service. Under the 1996 Act, then, the Commission must establish the mandated cost allocation rules. We believe that this is the proceeding in which the Commission should start to meet this obligation.

D. FUNDAMENTAL CHANGES IN ECONOMIC CIRCUMSTANCES AND REGULATORY POLICY REQUIRE THE COMMISSION TO MODIFY ITS COST ALLOCATION RULES.

Contrary to the claims of the local exchange companies,[11] reliance on a decade old cost order would be wholly inadequate to deal with the allocation of joint and common costs under the 1996 Act.

First, the nature of the underlying network architecture has changed dramatically. Digital line carrier for telephony and hybrid fiber coax architectures for video were virtually non-existent ten years ago. The massive joint and common costs inherent in the new architectures

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[9]Conference Report, p. 134.

[10]Conference Report, p. 129.

[11]GTE, p. 8; NYNEX, pp. 3, 15, 16; Pacific Bell, p. 10; Southwestern Bell, p. 3; US West, p. 5.

(60 to 75 percent) far exceeds anything contemplated at the time of the adoption of the joint cost order. Attachment 3 contains the relevant chapters from our local competition comments which define a system of cost concepts and analyze the video dialtone and local exchange cost allocation issue. It demonstrates the critical role that cost allocation plays in an integrated multi-product firm.

Second, the change in the industrial organization of the telecommunications industry brought on by the Telecommunications Act of 1996 requires a new look at joint and common cost allocation. In 1987, the local exchange companies were banned from equipment manufacture, information services, long distance and video. They have been or will likely soon be allowed into all of these lines of business. The incentive and ability to cross-subsidize and misallocate costs have been massively expanded.

Thus, we have a huge increase in the common costs which are shared between services and a dramatic expansion of the services that will be provided from joint and common plant. The decade old joint cost order is simply inadequate to deal with these changes.

E. THERE IS GROWING AND OVERWHELMING EMPIRICAL EVIDENCE THAT COSTS ARE BEING MISALLOCATED

USTA offers the observation that for the Commission to proceed with this cost allocation inquiry it must assume that rates currently are not just and reasonable or soon will not be, the LEC deployment of the network is inefficient, regulatory allocation is ineffective, and the local companies do not face competition in telephony.

> The Commission's proposal to engage in prescribing detailed cost allocations appears to be based on the notion that rates charged for current stand-alone telecommunications systems are unreasonable, or that joint use of the network will lead to unreasonable rates in the future. For either assumption to be valid, it would be necessary to conclude that the current network is inefficient, that the

Commission's current price cap and Part 64 are ineffective, and that existing telecommunications service will have no competition in the future.[12]

That sounds about right to us. As we pointed out in CFA's comments in the local competition proceeding, there is growing evidence that the current network costs being claimed for telephone service embody a variety of costs that are inappropriate.[13] Of direct relevance to this proceeding are misreported costs, misallocated costs, excess profits, inefficiencies, and strategic investments.

The Commission now has before it an increasingly precise set of estimates of the costs of an efficient, stand alone telephone network (see Table 1). One very important component of the

TABLE 1
ESTIMATES OF TSLRIC COMPARED TO EMBEDDED COSTS ($/MONTH)

AREA	THIRD PARTY		BCM		ARMIS
	SOURCE	AMT	MCI	ARMIS	EMB.
NATIONAL	HATFIELD I	21.35	16.71	23.04	32.96
	HATFIELD II	17.25			
PA	HATFIELD I	18.34	14.67	20.24	30.16
	HATFIELD II	15.08			
UT	HATFIELD I	14.83	15.09	28.01	37.93
	HATFIELD II	16.45			
CO	HATFIELD I	15.83	18.71	25.80	35.72
	HATFIELD II	17.84			
CA	HATFIELD I	14.94	13.09	18.05	27.97
	HATFIELD II	13.49			
WA	COMMISSION	10.50	17.02	23.48	33.40
	HATFIELD I	11.15			
FL	COMMISSION	19.00	14.79	20.40	30.32

[12]United States Telephone Association, p. 10.

[13]CFA, Competition Comments, p. 62.

	HATFIELD II	17.11			
IN	LECOM	18.22	14.93	20.58	30.50
	HATFIELD II	16.63			
ME	LECOM	22.96	24.83	34.24	44.16
	HATFIELD II	19.32			
IA	COMMISSION	15.55	22.90	31.58	41.50
	HATFIELD II	16.33			

SOURCES: See Attachment 4

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difference between embedded costs and TSLRIC costs of telephony are the strategic investments that LECs have made in anticipation of entry into non-regulated businesses. The Commission has noted one example of this in the massive amounts of excess capacity of fiber deployed throughout the network. The TSLRIC models show a second category of over investment -- switching. Least-cost engineering models deploy fewer than one quarter the number of switches as deployed by the LECs. These costs must be purged from the regulated account.

II. PROPER COST ALLOCATION IS NECESSARY

A. PRICE CAP REGULATION DOES NOT SOLVE THE ALLOCATION PROBLEM

Virtually all of the LECs claim that price cap regulation alone will protect telephone consumers of the multi-product LEC enterprises.[14] This is simply not true.

While price cap regulation may alter the incentives to shift costs and cross-subsidize competitive activities, it does not eliminate the need for cost allocation procedures. Properly targeted price cap regulation will prevent multi-product firms from raising the price of regulated services to cover every penny of misallocated costs, but it will not prevent a cost allocation

[14]Ameritech, p. 4, essentially drives all of its recommendations with this observation; Bell Atlantic, pp. 2-3; Bell South, pp. 4-5; GTE, pp. 2, 5; NYNEX, p. 5; Pacific Bell and Nevada Bell, p. 3; Southern New England Telephone Company, p. 1; Southwestern Bell, p. 21; USTA, pp. 3-5.

strategy that shifts costs improperly to regulated, non-competitive activities. Even with price cap regulation, the profit maximizing strategy is to recover the maximum amount of joint and common costs from the regulated sector. This allows the multi-product firm to achieve the largest market share in the competitive sector and to achieve the highest overall rate of profit for the firm.

Also, shifting costs into the regulated sector may depress the apparent productivity of regulated services. Because costs are too high, productivity is underestimated -- a benefit to those carriers who are subject to earnings based sharing. First, carrying spare capacity in anticipation of entry into new markets depresses overall productivity growth in the near term, even where all revenues are counted. Second, to the extent that regulators are unable to include the output of competitive services in their estimates of productivity or to properly assess the overall productivity of the firms, consumers of regulated services are "abused."

Even if the Commission were to adopt a productivity measure for total output of LECs, ratepayers of telecommunications services at the state level could still be harmed. By leaving costs in the regulated sector and, ultimately, leaving them in the state jurisdiction, state regulators are forced to deal with a higher cost base than is appropriate. State regulators cannot easily gain access to the total output data of the multi-state RBOCs. The RBOCs steadfastly resist providing interstate data to commissions. Since the Commission has pulled the video revenues into the federal jurisdiction, it should also pull an appropriate share of the video costs, including joint and common costs into the federal jurisdiction.

B. SUBSCRIBER-WEIGHTED ALLOCATORS DO NOT SOLVE THE COST ALLOCATION PROBLEM

A number of local companies propose an approach to cost allocation which is essentially a subscriber-weighted approach. They say that they should be allowed to allocate joint and common costs to video in proportion to the number of video subscribers that they win. These proposals which tie the allocation of common costs to the actual number of subscribers are blatantly anti-competitive and anti-telephone consumer.

US West, for example, starts by allocating 100 percent of the common plant to telephone subscribers.[15] If it wins a video subscriber, it would recalculate its allocator to lower the common costs allocated to telephone ratepayers. If it fails to win any video market, it still gets to recover it common costs from telephone ratepayers. This is essentially a risk-free approach which uses the telephone ratepayer as the guarantor of joint and common costs and is blatantly anti-competitive. Furthermore, it clearly violates §254(k) of the Act.

Bell Atlantic offers a modification which may appear to reduce, but does not eliminate the problem. In fact, with the elimination of the §214 approval process, Bell Atlantic's approach will do telephone ratepayers little, if any, good.

Bell Atlantic's numerical example can be used to illuminate the fundamental flaw in the subscriber-weighted approach to cost allocation.[16] Bell Atlantic argues that its telecommunications obligations require it to be prepared to serve all customers, therefore, it claims 100 percent for the telephone base. However, it expects to only achieve a market share of 35 percent for its video applications. Therefore, it suggests a costs allocator of 26 percent for video, as follows.[17]

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[15]US West, pp. 11-12.

[16]Bell Atlantic, p. 10.

[17]Bell South (p. 19) appears to advocate a similar approach as Bell Atlantic.

Video share = Video/ (Video + Telephone)

Video share = 35/(100 + 35) = 35/135 = 26

The fundamental flaw in this approach is that Bell Atlantic is still using the captive telephone subscriber as the guarantor of joint and common costs for video services. Unless Bell Atlantic knows exactly which subscribers will subscribe to its video service, it must deploy the common plant necessary to deliver video to many more subscribers than just the 35 percent who may take it. In fact, to achieve a 35 percent market share, Bell Atlantic is likely to have to deploy the necessary common plant widely throughout the network.[18] Bell Atlantic is at risk for 35 percent of the common costs it has allocated to the video market based on its projections of market share, but it incurs no risk of recovery of the joint and common costs for every telephone subscriber <u>who does not take</u> video service but is served from common video/telephony plant.

Under this approach, Bell Atlantic gets to decide the level of risk it wishes to face with respect to the common costs of the multi-product network by deciding what market share it will project. It has an obvious incentive to underestimate its market share. Since Bell Atlantic is no longer required to defend the economics of its video proposal to regulators in a §214 proceeding, the Commission has little leverage to ensure a reasonable allocation of costs.

C. LEAST COST, FORWARD LOOKING TELEPHONE COST CEILINGS ARE NECESSARY TO PREVENT CROSS SUBSIDY.

NYNEX presents a discussion of the subscriber-weighted approach which underscores the need to estimate a telephony cost ceiling. NYNEX argues that LECs have many options in

[18]This methodology gives Bell Atlantic an incentive to selectively deploy facilities where the take rate is likely to be highest (i.e. to redline low take rate areas).

deploying a multi-product network and that the Commission should not influence these choices with cost allocation rules. To the contrary, NYNEX's example shows the danger to telephone ratepayers that result from a failure to adopt such rules

> Different network architectures may be employed to provision telephony and video, and direct assignment will generally not be feasible for loop plant where both telephony and video signals will be carried over the same cable. It may be possible to directly assign the drop wires under an architecture where a separate coaxial drop would be required for video transmission to enter the set top box and a copper drop would be used for the telephone signal to enter the telephone set. However, under a switched digital video (SDV) architecture, which NYNEX is contemplating, a common drop will be employed for telephony and video. For such an architecture, the common costs could be allocated in proportion to the relative number of telephony and video service connections (i.e. a "virtual loop" methodology), as one example of a cost-causative methodology.[19]

This is a very bad example from the telephone ratepayer point of view. Suppose the LEC has a largely depreciated, copper drop network in place that is entirely adequate for telephony. Under the "subscriber-weighted. LEC decides technology and cost allocation approach," the LEC has no interest in deploying a network architecture that uses a second drop for cable service, since all of the costs will be allocated to the cable side of the business. If it deploys a single new drop to be jointly used. it gets to impose costs on telephone ratepayers. It imposes 100 percent of the costs of the drop from those telephone subscribers who do not choose to take the LECs cable service and 50 percent for those who do take the LECs cable service. All telephone subscribers may well have been better off with the copper drop already in place.

A similar conclusion applies to SNET's proposed 50/50 split. SNET's claims that subscribers are better off with a 50/50 split --

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[19]NYNEX, p. 11.

> In any case, it is plain that SNET's telephone ratepayers benefit since those ratepayers bear no more than 50 percent of the broadband loop common costs and none of the costs directly attributable to Personal Vision's cable service.[20]

Ratepayers are only better off if it can be shown that a 50 percent share of the common costs of an integrated network are less than 100 percent of the least cost telephony only application.[21] The CFA Competition Comments show this as one of the examples put forward in the video dialtone debate.

D. COST CAUSAL ANALYSIS INDICATES A 50/50 ALLOCATOR DOES NOT TREAT TELEPHONE RATEPAYERS REASONABLY

The 50/50 split proposal advocated by some telephone companies on which the Commission seeks comment, assumes, in essence that potential telephone and video subscribers are equal in their responsibility for costs. Our analysis of the nature of joint and common costs indicates that this is not the case. It is clear that video causes the local companies to deploy more fiber, more electronics, and more demanding switching and control technologies than telephony would require. The cable industry estimates a 3-to-1 ratio. MCI estimates a ratio of at least 62-to-38. A 50/50 split is inappropriate on the basis of cost analysis.

Its also unreasonable on the basis of its effect on ratepayers. The following Table shows

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[20]SNET, p. 17.

[21] Here it should be noted that SNET's witness, Dr. Taylor misdefines and miss applies the concept of subsidy. First he defines subsidy as prices below incremental cost. Subsidies have nothing to do with the allocation of common costs. He immediately misuses the concept of subsidy, claiming that the commission has created subsidies by misallocating common costs. By his own definition this cannot be the case, because allocation of common costs does not create a subsidy, only prices below incremental cost or above stand alone cost indicate the existence of a subsidy. Dr. Taylor fails to note that the incremental cost test is only one test for a subsidy. An equally valid test for the existence of a subsidy is a stand alone cost test. As we pointed out in our comments in the Competition proceeding it is critically important to pass both tests in the integrated multi-product firm.

the result of our analysis in the local competition docket, with the addition of two other allocators proposed in this docket -- the subscriber-weighted policy advocated by the LEC and the cable industry cost causative analysis.

We believe that a cost causative approach would yield a reasonable allocation of joint and common costs. The difference between the cable industry estimate of 3-to-1 and our 4-to-1 ratio based on electronics is relatively small. It is clear from this analysis that the subscriber-weighted approach advocated by the LECs overallocates costs to telephone ratepayers.

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TABLE 2
THE IMPACT OF ALLOCATORS FOR COMMON COSTS
ON COST RECOVERED FROM TELEPHONE SERVICE

METHOD		HARRIS (a)			JOHNSON (b)		
	RATIO OF VIDEO TO TELEPHONY	TELE CMN	TELE TOT	VIDEO	TELE CMN	TELE TOT	VIDEO
ALL TO TELEPHONE	0	600	900	100	550	800	850
SUBSCRIBER WEIGHTED	1:3	525	825	175	413	663	987
LOOP IS A LOOP	1:1	300	600	400	275	525	1125
CABLE COST ESTIMATE	3:1	150	450	550	138	388	1262
COST CAUSATIVE LOOP	4:1	120	420	580	110	360	1290
MINUTES OF USE	11:1	50	350	650	21	271	1379
BITS TRANSMITTED	800:1	6	306	684	3	253	1397

Sources see attachment 5.

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The 50/50 split which some have advocated still leaves telephone ratepayers bearing a much too large share of the burden. The subscriber-weighted approach leaves telephone ratepayers paying almost twice as much as a cost causative approach. The 50/50 split approach leaves them paying 50 percent more. These proposals are unreasonable.

III. RECOMMENDATIONS

The desire of the local exchange companies to be allowed to allocate service flexibly is unacceptable. Given their strong interest in allocating costs to telephone ratepayers, flexibility yields an ability to manipulate costs in such a way that consumers will be harmed and competition undermined.

A. FUNDAMENTAL PRINCIPLES

The fundamental principles for cost allocation under §254(k) should be as follows. Video services must be assigned all direct costs, plus a share of joint and common costs. Telephone services should be assigned joint and common costs at the lesser of the stand alone cost of a least cost, forward looking telephone only network or a cost-causative allocation of joint and common costs. The first two principles -- video exceeds incremental cost and telephony is below stand alone cost -- codifies the first prohibition on cross subsidy embodied in the first sentence of §254(k). The third principle -- the lesser of stand alone or allocated common costs -- codifies the principle of cost allocation embodied in second sentence of §254(k).

B. COST POOLS ARE NECESSARY

The Commission should establish a series of cost pools based upon the distinct economic and technological characteristics of the network components, as proposed in the Notice.

The allocators should be based upon analysis of the cost drivers in the underlying technology, not the projections of market share provided by LECs. It is abundantly clear that such market projections can be easily manipulated to provide a competitive advantage to the LECs and impose unreasonable joint and common costs on telephone ratepayers.

The Commission should adopt a fixed allocator of 3-to-1 for loop. Spare capacity should be allocated in the same proportion as the allocator identified for the category of costs.

The Commission should develop appropriate, usage-sensitive allocators for other categories of costs. Because excess capacity and excessive functionalities can be inappropriately allocated to telephone ratepayers if allocators are based on near-term usage or projections of demand, allocators should be based on engineering analysis of common costs.

C. COST PRINCIPLES SHOULD BE UNIFORMLY APPLIED ACROSS INDUSTRIES

CFA/ICA recommend that the same cost allocation principles adopted to protect telephone ratepayers when LECs enter the video business, should be adopted to protect cable ratepayers, when to cable operators enter the telephone business.[22] On this point we agree with the LECs.[23]

CONCLUSION

Wherefore, CFA/ICA urge the Commission to adopt rules on cost allocation for LEC video services which meet the criteria and avoid the anti-consumer, anti-competitive outcomes outlined above.

Respectfully submitted,

Bradley Stillman, Esq.
Telecommunications Policy Director
Dr. Mark N. Cooper
Research Director

Counsel for
Consumer Federation of America

Of Counsel:

Brian Moir
Moir and Hardman

Counsel for International
Communications Association

[22]"Comments of the Consumer Federation of America, In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, MM Docket No. 92-266, January 23, 1993, pp. 7, 8, 77-80, 91-92. CFA stressed that incremental costs could not be charged to new channels, but new channels had to make a fair contribution to joint and common costs and the goal of cost allocation was to keep basic services low.

[23]Ameritech, p. 7; Bell South, p. 5; Southern New England Telephone, p. 22; USTA, p. 11.

ATTACHMENT 1

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Amendments of Parts 32, 36, 61,	)	RM-
64 and 69 of the Commission's Rules	)	
to Establish and Implement Regulatory	)	
Procedures for Video Dialtone Service	)	

JOINT PETITION FOR RULEMAKING AND
REQUEST FOR ESTABLISHMENT OF A JOINT BOARD

CONSUMER FEDERATION OF AMERICA

Gene Kimmelman
1424 16th Street, N.W.
Suite 604
Washington, D.C. 20036
202/387-6121

NATIONAL CABLE TELEVISION ASSOCIATION, INC.

Daniel L. Brenner
David L. Nicoll
1724 Massachusetts Ave., N.W.
Washington, D.C. 20036
202/775-3664

Howard J. Symons
Leslie B. Calandro
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.
701 Pennsylvania Ave., N.W.
Suite 900
Washington, D.C. 20004
202/434-7300

April 8, 1993

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JOINT PETITION FOR RULEMAKING AND REQUEST FOR ESTABLISHMENT OF A JOINT BOARD

Consumer Federation of America[1/] and the National Cable Television Association,[2/] by their attorneys and pursuant to Section 1.401 and Parts 32, 36, 61, 64 and 69 of the Commission's rules, and Section 410(c) of the Communications Act of 1934, as amended, hereby petition for the commencement of a rulemaking to establish cost allocation rules for video dialtone service, and for the establishment of a Federal-State Joint Board to recommend procedures for separating the cost of local telephone company plant that is used jointly to provide telephone service and video dialtone.

1/ Consumer Federation of America (CFA) is the nation's largest consumer advocacy group, composed of over 240 state and local affiliates representing consumer, senior citizen, low-income, labor, farm, public power and cooperative organizations, with more than 50 million individual members. As ratepayers, CFA's members have a direct interest in the outcome of this proceeding.

2/ The National Cable Television Association (NCTA) is the principal trade association of the cable television industry. Its members provide cable television services to approximately 90 percent of the nation's cable television subscribers. NCTA's members have a direct interest in the outcome of this proceeding.

INTRODUCTION AND SUMMARY

When the Commission authorized local telephone companies to offer video dialtone service,[3/] it left critical implementation issues unresolved. Rather than adopt comprehensive video dialtone-specific rules to govern such matters as jurisdictional separations, cost allocation, pricing, and consumer safeguards, the Commission apparently believed that it could address these issues as they arose, in the context of applications for authorization to construct video dialtone facilities.

It is clear now, however, that this ad hoc approach will not work. Pending before the Commission are three video dialtone applications[4/] that, if granted, would force basic ratepayers in just the three affected service areas to bear the costs of millions of dollars in fiber optic lines being installed for video services and would undermine fair competition in the video

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3/ See Telephone Company/Cable Television Cross-Ownership Rules, Second Report and Order, 7 FCC Rcd. 5781 (1992) ("Video Dialtone Order"). The Video Dialtone Order expanded the role of local exchange carriers in the video marketplace by authorizing them to construct a basic common carrier platform for video programmers and to offer enhanced services to unaffiliated program suppliers. Carriers must provide access to the platform on non-discriminatory terms and conditions.

4/ A fourth application, for a video dialtone trial, was recently approved by the Commission. The Commission there held that accounting of only direct incremental costs incurred in the provision of the basic video dialtone was acceptable, but only because the application involved a technical trial of video dialtone rather than a full-scale offering of video dialtone service. Thus, the Commission's approval of that trial does not resolve the broader cost allocation issues raised in this Joint Petition.

marketplace. A careful analysis of these applications highlight the risks to consumers and competition:

- New Jersey Bell proposes to assign one hundred percent of the costs of new fiber trunks to telephone ratepayers -- even though it is crystal clear that only a small fraction of these new facilities will be used for telephone service. The overwhelming proportion of this capacity will be used for video dialtone service.

- According to a new study by Hatfield Associates, appended to this Joint Petition, telephone ratepayers nationwide could pay billions of dollars in unjustified rate increases each year unless effective cost allocation rules are implemented.[5/]

- The pending applications demonstrate that the threat of cross-subsidy remains alive and well with respect to video dialtone offerings, notwithstanding earlier speculation that existing regulatory safeguards and the purportedly eroding monopoly power of local exchange carriers had reduced that threat.[6/]

The manifest flaws in the pending applications are a direct result of the lack of cost allocation rules for video dialtone. In the absence of a clear set of standards to ensure that ratepayers do not subsidize the substantial costs of constructing and operating video dialtone facilities, there will doubtless be more applications that attempt to exploit this gaping hole in the regulatory scheme. Safeguards developed on a case-by-case basis in reaction to flawed applications cannot effectively address

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5/ Hatfield Associates, CROSS-SUBSIDY CONCERNS RAISED BY LOCAL EXCHANGE CARRIER PROVISION OF VIDEO DIALTONE SERVICES (Mar. 29, 1993), at 28-30 (attached hereto as Appendix A).

6/ See New Jersey Cable Television Association Reply to Opposition to Petition to Deny, File No. W-P-C-6840 (Filed Feb. 12, 1993), App. A (Affidavit of Leland L. Johnson) at 2-3 ("Johnson Affidavit").

what is clearly a generic problem, and the process of developing conditions for each new application will consume substantial governmental and private resources.

The Commission itself recognized that the applications review process might not be the best forum for dealing with these matters. It is past time to institute a comprehensive proceeding to address questions with respect to jurisdictional separations, cost accounting, access charges, and other consumer and competitive safeguards in the video dialtone context. Specifically:

- The Commission should establish a Federal-State Joint Board to recommend the proper allocation of plant used jointly for telephone and video transmission services.

- The Commission should adopt video dialtone-specific cost accounting rules to safeguard consumers and ensure fair competition.

- The Commission must determine the proper application of its access charge and price cap rules to video dialtone.

- The Commission should adopt procedures for separating the costs of regulated and non-regulated video dialtone services.

- The Commission should adopt video dialtone-specific rules for joint marketing and customer privacy.

The rules developed in the proceeding we propose will provide needed guidance to local exchange carriers that wish to offer video dialtone services, and to state regulators, consumer advocates, and others whose interest is in seeing that the implementation of video dialtone does not come at the expense of basic ratepayers or fair competition in the video marketplace.

Until completion of the rulemaking we seek, pending video dialtone applications should be held in abeyance and the Commission should refrain from accepting any new video dialtone applications. At a minimum, approval of any video dialtone application prior to the adoption of the basic safeguards we are requesting should be conditioned on compliance with those safeguards.[7/]

I. IN VIEW OF THE PENDING APPLICATIONS TO PROVIDE VIDEO DIALTONE, THE COMMISSION MUST ACT PROMPTLY TO ESTABLISH RULES FOR SEPARATIONS, COST ACCOUNTING AND COST ALLOCATION

While the Commission itself originally sought comment on the need for changes in Parts 32, 36, 64, and 69 of its rules to implement video dialtone,[8/] it ultimately chose not to make those changes. Numerous parties in the cable-telephone cross-ownership proceeding have taken issue with the Commission's failure to establish rules to govern such matters as jurisdictional separations and cost allocation at the same time as it authorized the provision of video dialtone services.[9/]

7/ A video dialtone offering approved prior to the adoption of the safeguards would be subject to a retroactive reallocation of costs, if such a reallocation is necessary to bring the offering into compliance with the safeguards.

8/ Telephone Company-Cable Television Cross-Ownership Rules, Further Notice of Proposed Rulemaking, 7 FCC Rcd. 300, 321 (1991).

9/ Many of the parties who supported the adoption of video dialtone-specific safeguards have sought reconsideration of the Video Dialtone Order. See, e.g., Petition for Reconsideration of National Cable Television Association, Inc. (filed Oct. 9, 1992) at 7-9; Petition for Reconsideration of Consumer Federation of America (continued...)